

Fiscal Services Division

Accounting Action Plan 2006



*Fiscal Services Division Plan To
Enhance Financial Integrity*



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FCSD Accounting Action Plan

Executive Summary

The Fiscal Services Division completed a plan to increase the financial integrity and accountability of its processes and procedures. With the Sarbanes-Oxley Act of 2002 (Section 404 regarding management assessment of internal controls) and increased scrutiny of the department by the corporate world, an opportunity is presented to significantly strengthen our internal accounting and administrative controls. This plan will acknowledge where deficiencies exist from previous audits and address measures to assure California Public Employees' Retirement System (CalPERS) management that adequate controls are in place.

With the theme of prior audits being similar, the Fiscal Services Division will initially focus on key audit findings. Our goal is ensure compliance with the Review of Internal Controls, SAM 20060, Financial Integrity and State Manager's Accountability. Additionally, we will address all current findings in the latest Deloitte and Touche Management Memo with the assistance from the Office of Audit Services staff. Fiscal Services Division will also review outstanding internal audit findings and implement work plans to address these findings. In order to address these findings within a reasonable timeframe, additional resources will be needed. The Division will place a higher emphasis on management review for improved oversight and adherence to departmental policies.

Other objectives of the plan include assessing staff resources and skills, documenting current and new processes, analyzing where reconciliations are completed or must be initiated, and formalizing more division management review procedures. An assessment of staff will be completed to determine training and resource requirements. To assist staff in understanding their roles and responsibilities, processes will be documented and articulated to all staff. The Division will determine where reconciliations exist and the meaning and purpose of them in order to identify areas where they must be implemented. In addition, the Division will implement more formal review procedures

and tracking reports to insure the information is reliable and monitor compliance with due dates.

Goal and Objectives

The goal of this action plan is to implement internal controls that will ensure financial integrity. Fiscal Services Division will accomplish this goal by completing the following objectives:

- Objective 1 – Reconcile all general ledger accounts.
- Objective 2 – Train and develop all accounting staff to meet governmental accounting standards, fiscal expectations, and customer needs.
- Objective 3 – Address all outstanding audit findings.
- Objective 4 – Ensure the accounting structure is aligned with financial information needs.
- Objective 5 – Document accounting processes.

Organization Structure

To achieve the level of performance which meets the Executive Team's enhanced expectations, Fiscal Services Division recently restructured the division. The new organization structure includes two Accounting Administrator III's and a Staff Services Manager III. The addition of the new Accounting Administrator III and the new Staff Services Manager III were approved to provide greater oversight and direction for all accounting and budget activities related to the various retirement, health and investment programs administered by CalPERS. The management team will proactively address the internal and external audit findings and continuously work towards improving the financial integrity of its processes and procedures.

The existing Accounting Administrator III oversees all of the accounting support functions including: cashiering, financial system support, and enterprise-wide special projects such as Enterprise Management of Billing, Accounts Receivables and Collections (EMBARC) and Pension System Resumption (PSR).

The newly appointed Accounting Administrator III manages the Investment Accounting, Retirement Program Accounting and the Fund Accounting units. Furthermore, this Accounting Administrator III will monitor the work progress for complex programs such as the Long Term Care, Self Funded Health Insurance programs, State Savings Plus plan financial report, and the Supplemental Savings Program.

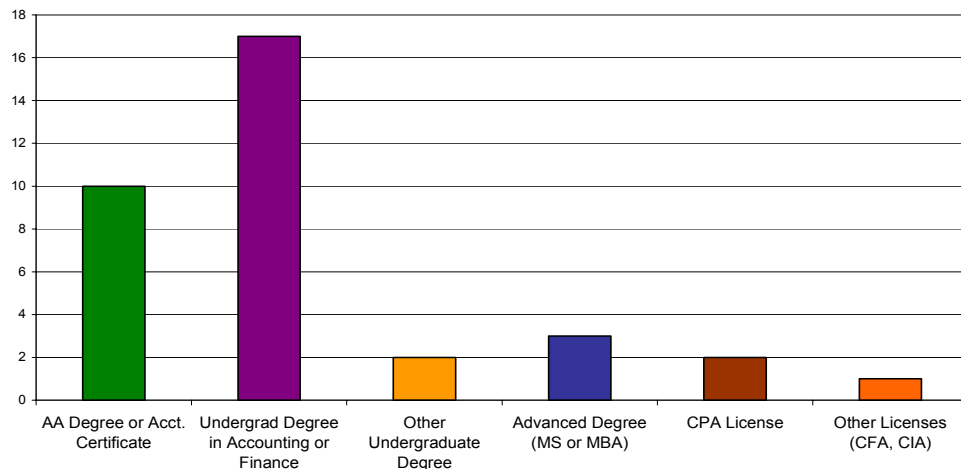
The Staff Services Manager III directs the Program Budget, Technical Budget and Administrative Accounting Units. With the addition of the new Staff Services Manager III, the Budget Unit is able to provide the necessary financial analysis, forecasting and management reports to Senior Management and the Executive Team and the Administrative Accounting Unit will be able to ensure the integrity of the internal systems.

Assessment of Staff Skills

The Fiscal Services Division recognizes the need for staff to have strong accounting knowledge and technical skills. A concerted effort has been made to recruit college graduates with accounting degrees. This has been accomplished by recruiting through the open Accountant Trainee classification. Five of Fiscal Services Division's recent recruits all have accounting or finance degrees. Of the five candidates, one possesses an advanced degree, another is enrolled in the advanced degree program and a third is completing her CPA qualifying experience.

The chart below represents the results of a preliminary assessment of staff performing the primary accounting duties in the division. The preliminary assessment included a total of 37 staff from the Investment Accounting Section, Retirement Program Accounting Unit and Fund Accounting Unit. The results show that 73% of staff has an undergraduate degree in accounting or finance, AA degree or accounting certificate. Please note that staff polled may fall into more than one category represented on the chart.

**FCSD – Accounting Staff Assessment
(37 Staff Polled)**



FCSD also recognizes the need to retain qualified staff. Accordingly, a strategy of retaining these employees is achieved through promotional career path opportunities. Providing an open exam is not a feasible option for the limited number of CalPERS Accountant Trainee positions. Therefore, CalPERS Human Resources Division (HRSD) was able to obtain consent from a few departments to use their open lists. In conjunction with using the open exam lists, as positions become vacant they will be recruited for at the Accountant Trainee level. As staff develop and more responsibilities are added to those positions, upgrades to Accounting Officer and subsequently Associate Accounting Analyst would be considered as appropriate. These strategies have been developed in conjunction with HRSD.

In addition to recruiting qualified staff, Fiscal Services Division has identified several areas where additional training is needed for staff such as: developing analytical skills, more advanced industry training for investment and pension fund accounting, additional knowledge regarding the real estate industry and a working knowledge of the CalPERS investment operations. Fiscal Services Division has also determined that greater collaboration is needed with the master custodian, Bank of America and the real estate partners to ensure the financial integrity of CalPERS data.

As a part of this Action Plan, Fiscal Services Division will conduct a survey of all the accounting staff to identify the knowledge and skills already possessed by staff as well as the areas that require additional training and development. In doing so, Fiscal Services Division will identify and analyze the staff mix to determine viable options for the Fiscal Services Division. Some of the questions that will be addressed are as follows:

- Are the job classifications appropriate and are the individuals performing the appropriate duties for their classifications?
- Are there workload and resource issues?
- Does staff have the appropriate skill sets (education and experience) to perform the duties assigned?
- What additional training needs are required to ensure that staff is working at peak performance?
- Is Fiscal Services Division structured appropriately to provide the most efficient and effective use of its resources?

- Where does cross-training need to occur and how can we fill the gaps?

Fiscal Services Division intends to distribute the survey in mid-February and based on the results, will establish a work plan to implement an internal training program as well as a clear and defined training path for all staff.

Account Reconciliations

Account reconciliations are an essential component of the financial control environment. Reconciliations validate that all other accounting controls are working and the records are complete and accurate. Past reviews by auditors have recommended reconciliation improvements that have been implemented with further enhancements underway. The added and upgraded reconciliations have provided staff with a greater confidence in the integrity of the financial data. The Fiscal Services Division's intent is to reconcile all accounts within the appropriate time frames that meet the requirements of State Administrative Manual Chapter 7900 and ensure accurate and complete financial records.

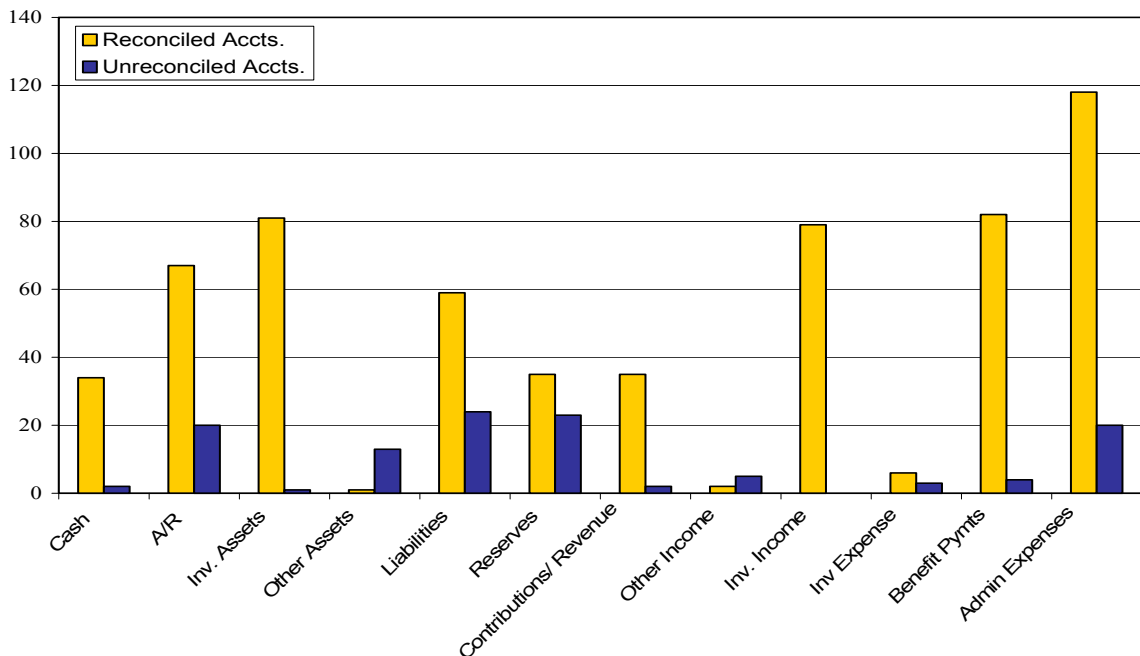
Reconciliation methods include comparing independent sources of data, using algorithms to recreate the same results, recreating the records through an alternative procedure, performing account analytics, reasonableness checks, and other methods. A reconciliation process is designed with one or a combination of the methods so that it achieves the best results appropriate for the situation. The end result of a well designed reconciliation process provides absolute confirmation that the accounting records are accurate. If a variance is identified, the specific cause of the variance can be identified, analyzed and corrected. These are the practices that Fiscal Services Division will implement.

Reconciliations usually come at the end of the accounting process but can sometimes occur after each transaction posting. Fiscal Services Division has always performed the most important reconciliations for accounts which affect cash that include but are not limited to accounts such as cash receipts and cash disbursements. An example is a daily reconciliation of wire transfers being initiated at the recommendation of the Office of Audit Services to mitigate the risk associated with these types of transactions. Fiscal Services Division will develop reconciliations for all accounts with our first priority being accounts that

contain cash or are determined to be significant and material. Fiscal Services Division's goal is to reconcile all of our accounts. The following charts summarize the status of general ledger account reconciliations to date.

Summary of Reconciled Accounts

<i>Account Category (All Funds)</i>	<i>Total Number Of Accounts</i>	<i>Number of Accounts Reconciled</i>	<i>Percentage of Accounts Reconciled</i>
Cash + Equivalent	36	34	94%
Accounts Receivable	87	67	78%
Investment Assets	82	81	98%
Other Assets	14	1	7%
Liabilities	83	59	71%
Reserves	58	35	60%
Contributions/Revenue	37	35	94%
Other Income	7	2	28%
Investment Income	79	79	100%
Investment Expense	9	6	66%
Benefits/Health Payments	86	82	95%
Administrative Expenses	138	118	85%
Totals	716	599	83%



Control Tracking Sheets and Evidence of Review

Auditors have noted in management letters and audit reviews that Fiscal Services Division does not document all of the managerial reviews that it performs. In addition, they have recommended that division managers be able to track the status or review progress of certain reports, transactions, and activities. To address the auditors' concerns, Fiscal Services Division has plans to implement corrective action by requiring: written evidence of preparation and supervisory review, Control Tracking sheets for certain documents and reports and Supervisory Status Logs for certain activities and processes.

In response to past audits, Fiscal Services Division has added evidence of preparer and reviewer to the face of various accounting documents. In addition, some activities are required by oversight agencies (i.e., State Controller's Office) or the State Administrative Manual to have transmittal documents that indicate evidence of preparation and review. To ensure compliance with the auditors' recommendations, Fiscal Services Division will implement the following:

- Compile a list, by Fiscal Services Division sections, identifying documents and reconciliations requiring review (1st and 2nd level) and submit a list to a project team coordinator.
- For each item on the listing, determine if there is evidence of preparation and review on the face of the document (and the supporting schedules) or if there should be a control/tracking sheet.
- For each section in Fiscal Services Division, identify documents, reports, or deliverables (i.e. board exhibits, basic financial statements (BFS) within the Comprehensive Annual Financial Report (CAFR), etc.) requiring several levels of review/approval that should have a Tracking/Control sheet. In addition, identify and include documents that ultimately leave Fiscal Services Division for use by another entity or executive management.
- Consider that some activities/functions (i.e. BFS, certain Budget documents) may require more than a cursory review to determine where evidence of review and/or tracking is needed.
- Once the items needing evidence of review (signature and date) and/or control tracking are identified, the project team will use the information to develop a division-wide policy.

- Performance evaluations for supervisors and managers will include accountability to ensure proper controls are in place and utilized.
- Identify and cross-train secondary preparers to ensure timely completion of work and coverage for vacations, absences, etc.

A generic Control Sheet has been developed for documents or activities needing a Control Tracking sheet to show evidence of preparation/review and approval. It is possible that Fiscal Services Division will have more than one of these forms, depending on the nature of the items in need of such tracking.

Lastly, to increase responsiveness to management status inquiries, Fiscal Services Division supervisors will maintain Status Logs for critical activities in their sections. These logs will be updated regularly to provide response to management related to the progress of activities/reconciliations/reports.

Process Documentation

A key component of financial integrity and compliance with Sarbanes Oxley is maintaining an adequate internal control structure and procedures for financial reporting. The Fiscal Services Division is committed to ensuring an appropriate level of documentation exists and has taken steps to meet this objective.

Although many processes have been documented in the past, Fiscal Services Division is working towards a uniform and comprehensive product. The division is developing an operating plan which includes documentation at the unit level. The plan consists of two phases and several sections as outlined below:

Operating Plan

Phase I:

- Section A - Unit Mission/Purpose
- Section B - Unit Goals and Objectives
- Section C - Unit Organizational Chart
- Section D - Unit Process List
- Section E - Activity Analysis
- Section F - Workload Statistics
- Section G - Performance Measures
- Section H - Monthly/Yearly Work Plan
- Section I - Calendar of Events

Phase II:

Section A - Unit Process Maps

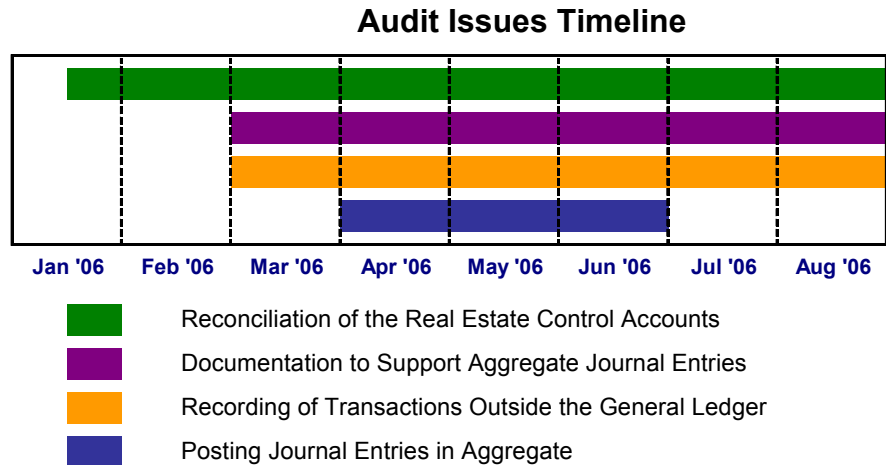
Section B - Unit Process Narratives

Section C - Unit Desk Procedures

Fiscal Services Division has completed Sections A-F of Phase I, and is working towards completing the rest of Phase I by June 2006. A Phase II implementation schedule will be developed upon completion of the first phase.

A fundamental part of the operating plan is process analysis and documentation. It is Fiscal Services Division's plan to prioritize and focus on processes identified in audit findings. Fiscal Services Division will immediately begin to address the following:

- Reconciliation of the Real Estate Contribution and Distribution Control Accounts:
Establish a reconciliation process for capturing information in the real estate distribution and contribution control accounts. This will include completing the monthly reconciliation for FY 2005-06.
- Investment Accounting General Ledger Support:
Explore the possibility of using the investment accounting general ledger accounts to directly produce the financial statements. Fiscal Services will research the best practices of similar retirement systems including Los Angeles County Employees' Retirement Association (LACERA) and Colorado Public Employees' Retirement Association (PERA).
- Recording of Transactions Outside the General Ledger:
Research and identify an alternative to eliminate the use of Excel spreadsheets to support the amounts in our financial statements.
- Posting Journal Entries in Aggregate:
Develop a policy and procedure to ensure all journal entries are properly supported, reviewed and approved by management to provide an adequate audit trail.



Consistency Between CalPERS and the Master Custodian

Various audit reviews have recommended that there be more consistency between the Master Custodian and Fiscal Services Division (Investment Accounting in particular). Specifically, the auditors have concerns that the Master Custodian’s system does not directly mirror the Fiscal Services Division (PeopleSoft) General Ledger, therefore requiring reclassifications and standard (manual) adjusting entries by Investment Accounting staff to ensure accurate reporting of financial activity in PeopleSoft.

The current Master Custodian contract with State Street expires on June 30, 2006, and the selection process for the next Master Custodian is currently underway. This matter will still be an issue for consideration regardless of who is awarded the new Master Custodian contract.

The Investment Accounting staff is using source data to adjust the Master Custodian information in the general ledger electronic transmission. These adjustments are not because of PeopleSoft limitations but more because of the differences in the accounts used by the Master Custodian and the reporting detail needed to properly reflect financial activity in CalPERS financial statements.

To resolve the differences between the Master Custodian and PeopleSoft, Fiscal Services Division will determine if sections other than Investment Accounting are experiencing similar situations with information in the Master Custodian’s general ledger transmission. Once all issues are identified, Fiscal Services Division will examine

possible solutions to ensure consistency between our PeopleSoft general ledger accounts and the Master Custodian.

Consulting Services

External Resources (Contractor)

To ensure that Fiscal Services is moving forward with its efforts towards compliance with the Review of Internal Controls, SAM 20060, Financial Integrity and State Manager's Accountability, Fiscal Services will hire a contractor to review our internal control processes and procedures.

The contractor must ensure that Fiscal Services has established and is maintaining an adequate internal control structure. The contractor's review must encompass relevant evidential matter. This will include documentation of policies and procedures to provide support for management's assessment of the effectiveness of the CalPERS internal financial reporting controls. The contractor must also thoroughly document any deficiencies and recommend clearly defined solutions for implementation by CalPERS. These requirements will ensure accountability and responsibility for:

- Safeguarding public assets
- Addressing identified deficiencies
- Implementing and maintaining a strong control environment
- Improved accuracy and reliability of financial information

The contractor will also design a control testing plan that will be provided to our external auditors annually. Lastly, the contractor will create and provide a Risk Control Matrix to CalPERS management for planning purposes. A well-developed Risk Control Matrix will provide a basis for allocating resources to address controls related to critical functions/activities.

The following outlines the process to hire a contractor by the end of April 2006:

1. Contact the Investment Office (INVO) to determine the feasibility of using their pool of contractors who they already have existing contracts with. This process was previously used by the Office of Audit Services (OFAS) to quickly hire KPMG for the Investment Cash Control issue.

2. If using the INVO pool is not feasible, Fiscal Services will work with the Operations Support Services Division (OSSD) to determine the most expedient method to hire a contractor:
- With OSSD's assistance, determine the proper document type to use
 - Complete the document and send to OSSD for review
 - Determine which contractors the document should be sent to
 - Review contractor responses to the solicitation
 - Interview and rank prospective contractors
 - Select a contractor and have the appropriate documents signed
3. Fiscal Services will need to determine:
- Budget
 - Duration of services/contract
 - Scope of services
 - Statement of work
 - Deliverable based or hourly
 - Prospective contractors to solicit
 - Number of consultants needed
 - Office space for consultants

Internal Resources (Office of Audit Services)

As part of our on-going effort to address our management letter issues, the Office of Audit Services has agreed to re-direct four audit staff to work in the Fiscal Services Division. These four staff will be assigned to work in the Investment Accounting section and will functionally report to the Assistant Division Chief in the Fiscal Services Division. They will assist with the real estate reconciliation process as well as documenting other accounting policies. Their primary focus is to address the management letter issue related to the real estate contribution and distribution account so that it will not become a repeat finding.

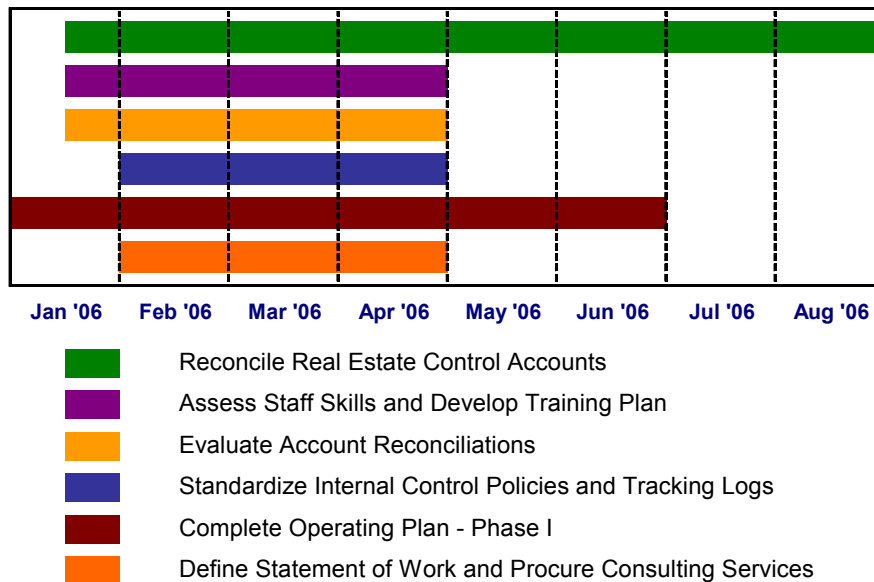
The following is a list of assignments that the audit staff will work on (subject to change as needed):

1. Reconcile the real estate contribution and distribution general ledger accounts monthly for FY 2005-06. The primary task will be to reconcile these accounts from July 2005 through June 2006.

2. Review accounting policies and procedures
3. Update policies and procedures that directly impact outstanding audit issues.
4. Prepare documentation to train staff on the real estate contribution and distribution general ledger account reconciliations.
5. Develop flowcharts to graphically represent accounting processes and procedures.
6. Review accounting chart of accounts and determine additional reconciliation needs.

Timeline

Proposed Plan Timeline



Conclusion

Through the processes identified in this plan, Fiscal Services Division will implement internal controls that will further ensure financial integrity. The Sarbanes-Oxley Act of 2002 and increased scrutiny of the CalPERS by the corporate world presents an opportunity to elevate our internal and administrative controls. With the primary objectives of this plan to:

- Reconcile all appropriate accounts.
- Train and develop all accounting staff to meet fiscal expectations and customer needs.
- Address all outstanding audit findings.
- Ensure accounting structure is aligned with financial information needs
- Document accounting processes.

Fiscal Services Division will strengthen efficiency and control for all funds and programs maintained by CalPERS. The end of the plan does not signal that we are done, but represents an initiation of the continued review and evaluation of the fiscal processes to exceed the needs of the department and safeguard our members' financial security.